

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 99-0151 FIT
Gross Income Tax
For Tax Periods: 1994 through 1996**

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ISSUES

I. Gross Income Tax—Leasing Activities

Authority: *Indiana-Kentucky Elec. Corp. v. Indiana Dept. of State Revenue*, 598 N.E.2d 647, (Ind.Tax Ct. 1992); *First National Leasing v. Indiana Dept. of State Revenue*, 598 N.E.2d 640 (Ind.Tax Ct. 1992)
45 IAC 1-1-17; 45 IAC 1-1-49; 45 IAC 1-1-51

Taxpayer protests the characterization of certain receipts as Indiana gross income.

II. Gross Income Tax—Depreciation Deduction

Authority: *Associated Insurance Companies, Inc., v. Indiana Dept. of State Revenue*, 655 N.E.2d 1271 (Ind.Tax Ct. 1995)
IC 6-2.1-4-3; IC 6-2.1-5-5(b), (c); IC 6-2.1-4-1(d); IC 6-2.1-4-6(a)

Taxpayer protests the disallowance of depreciation deductions claimed by its consolidated group.

STATEMENT OF FACTS

The Department conducted an audit of taxpayer—a Delaware corporation who, along with its subsidiaries, file one consolidated gross income tax return with the State of Indiana—for tax periods 1994 through 1996. The audit resulted in proposed assessments of Indiana gross income tax. The proposed assessments involve issues relating to two of the corporate members of taxpayer's affiliated group. Taxpayer now protests these proposed assessments.

I. Gross Income Tax — Leasing Activities

DISCUSSION

One member of taxpayer's consolidated group ("Dealer") operates vehicle dealerships in Indiana. The Dealer's customers may either purchase or lease their desired vehicle. Among the many financing options available to the Dealer's customers is the leasing of the vehicle through HLC, a leasing company. HLC is an out-of-state corporation and another member of taxpayer's consolidated group. (HLC is a wholly-owned subsidiary of NFC, which is a wholly-owned subsidiary of taxpayer.) HLC has no employees in Indiana.

The HLC leasing option is one of many financing options the Dealer can offer its customers. If a customer of Dealer is interested in HLC's services, he/she fills out a credit application at the dealership. The application is forwarded to one of NFC's district offices in either Illinois or Ohio. If the customer passes the credit check, the district office sends to the Dealer a finance sales proposal to give to the customer. The Dealer informs the district office of the customer's final decision regarding the proposal. In all instances, the leases are signed and accepted by HLC, by its parent company NFC, in Illinois. HLC sends all bills to lessees from Illinois, and all lease payments are sent by lessees to HLC in Illinois.

Audit contends the income received by HLC from leases made to Indiana customers should be included in taxpayer's consolidated Indiana gross income (high rate). Taxpayer argues this income should be excluded from its Indiana gross income because the lender/lessor (HLC) has no "tax situs" in Indiana with regard to this income.

45 IAC 1-1-17 provides in pertinent part that: "'gross income' and 'gross receipts' mean the entire amount of gross income received by a taxpayer. This includes all income actually or constructively received." Here, the income in question is the lease income received by HLC for financing and leasing vehicles located in Indiana. Lease income is considered an intangible for gross income tax purposes. *See* 45 IAC 1-1-51. Intangible means a personal property right, which exists only in connection to something else. *Id.* In general, receipts derived from an intangible are included in gross income unless the intangible does not form an integral part of a trade or business situated and is not regularly carried on at a business situs in Indiana, and the taxpayer's commercial domicile is located outside Indiana. *Id.* Both taxpayer and HLC are commercially domiciled outside of Indiana.

Determining the taxability of income from intangibles is a two part test. 45 IAC 1-1-51. (Emphasis added). The first test, the "business situs" test, provides that if the taxpayer has established a business situs in Indiana, and "the intangible forms an integral part of a business regularly conducted at [that] situs," then the intangible has an Indiana situs for tax purposes. *Id.* The second test, termed the "commercial domicile" test, holds that if the taxpayer has established its commercial domicile in Indiana, "all of the income from intangibles will be taxed . . . except that income which may be directly related to an integral part of a business regularly conducted at a 'business situs' outside Indiana." *Id.* If the taxpayer has established its commercial domicile in another state, then "no income from intangibles will be taxed . . . unless the taxpayer has also established a business situs in Indiana and the intangible income derived therefrom forms an integral part of that Indiana activity." *Id.*

Pursuant to 45 IAC 1-1-49, a taxpayer may establish a business situs in ways including, but not limited to, the following:

(1) Use, occupancy or operation of an office, shop, construction site, store, warehouse, factory, agency route or other place where the taxpayer's affairs are carried on;

(2) Performance of services;

...

(5) Acceptance of orders without the right of approval or rejection in another state;

(6) Ownership, leasing, rental or other operation of income-producing property (real or personal); . . .

45 IAC 1-1-49.

Taxpayer concedes that it has a business situs in Indiana. HLC has an investment in real estate located in northern Indiana whereby HLC leases real estate to taxpayer. However, we find that taxpayer has a second business situs in Indiana. Taxpayer, through HLC, leases and takes an ownership interest in income-producing property in Indiana, *i.e.*, the leased vehicles. Therefore, as provided by 45 IAC 1-1-49(6), taxpayer has business situs in Indiana related to its leasing of real estate and its leasing of vehicles.

Although taxpayer, through HLC, has a business situs in Indiana related to the leasing of vehicles in the state, it must be determined whether HLC's business situs is also the "tax situs" or "source" of its income from the leasing activities. *See Indiana-Kentucky Elec. Corp. v. Indiana Dept. of State Revenue*, 598 N.E.2d 647, 662 (Ind. Tax Ct. 1992) (finding that Ohio corporation was not subject to imposition of gross income tax for sales of electricity to Indiana customers, where Ohio corporation had no tax situs within Indiana). We do this by examining whether the transactions giving rise to the intangible income are an integral part of HLC's Indiana business activities.

In support of its contention that the HLC leasing income should be excluded from its Indiana gross income because HLC has no "tax situs" in Indiana with regard to this income, taxpayer cites *First National Leasing v. Indiana Dept. of State Revenue*, 598 N.E.2d 640 (Ind. Tax Ct. 1992). Taxpayer believes its situation is the same as in *First National Leasing*.

In that case, First National Leasing leased train derailment equipment to Hulcher Corporation, a wholly owned subsidiary. The equipment was used to place railroad cars and locomotives back on the tracks after a derailment. The lessee had a base in Indiana at which it stored some of the leased equipment. The Court decided that the taxpayer did not owe Indiana income tax on the income from the leases in that case because First National Leasing (taxpayer-lessor) had no control over the equipment.

In *First National Leasing*, the Indiana Tax Court specifically held that the income earned by an out-of-state corporation from leasing train derailment equipment to its wholly owned out-of-state subsidiary, who in turn, independently located the equipment in Indiana, was not derived from Indiana sources. The subsidiary did not make a lease payment to First National Leasing from Indiana. Here, by contrast, the taxpayer is not leasing to its out-of-state subsidiary, but rather, is the out-of-state subsidiary leasing to Indiana customers.

Furthermore, HLC's primary business is financing and leasing vehicles. The vehicles are delivered to the lessees at the dealerships. The leases are for over-the-road trucks that must be titled and licensed in Indiana for road use. HLC requires information from its lessees each year regarding the location of the leased vehicles for property tax purposes. As such, the income in question is directly connected with the leasing and financing of the vehicles in Indiana. Since the vehicles that are financed or leased are generally located in Indiana, the lease income represents an integral part of taxpayer's Indiana business activities. Thus, taxpayer has not demonstrated a lack of business situs or that the lease income is not an integral part of the income derived from its Indiana activities. The Department, therefore, finds that taxpayer's Indiana-based vehicles also represent an Indiana tax situs for purposes of imposition of Indiana's gross income tax.

FINDING

Taxpayer's protest is denied.

II. Gross Income Tax — Depreciation Deduction

DISCUSSION

ICC, a wholly-owned subsidiary of taxpayer, is a member of taxpayer's consolidated filing group for gross income tax reporting purposes. In computing its Indiana gross income, ICC deducted all sales involved in interstate commerce as well as all sales made to the parent of its consolidated group (as inter-company sales). These deductions effectively eliminated all of ICC's taxable income for gross income tax purposes. ICC, however, also was entitled to a depreciation deduction for a resource recovery system pursuant to IC 6-2.1-4-3. Since ICC had no taxable Indiana gross income, this depreciation deduction was used to offset Indiana gross income generated by other members of the consolidated group. Audit disallowed the deduction. Audit contends the deduction may be used only by ICC and not by the consolidated group. Taxpayer, in response, argues that the depreciation deduction may be applied against the full amount of its consolidated gross income tax liability.

A depreciation deduction is allowed for qualified resource recovery systems. Specifically, IC 6-2.1-4-3 provides:

If for federal income tax purposes a taxpayer is allowed a depreciation deduction for a particular taxable year with respect to a resource recovery system . . . the taxpayer is entitled to a deduction from his gross income for that same taxable year. The amount of

the deduction equals the total depreciation deductions that the taxpayer is allowed, with respect to the system, for that taxable year under Sections 167 and 179 of the Internal Revenue Code.

All parties agree that ICC was entitled to this depreciation deduction. The parties, however, are at odds with regard to the application of this deduction. Audit believes the deduction may be used only to offset income attributable to ICC; taxpayer asserts the deduction may be used to offset income attributable to the consolidated group.

The Indiana Tax Court has addressed a similar issue with regard to the application of an income tax credit against consolidated gross income tax liability. In *Associated Insurance Companies, Inc. v. Indiana Dept. of State Revenue*, 655 N.E.2d 1271 (Ind.Tax Ct. 1995), the Court found that individual affiliated group members were entitled to apply their income tax credits against the entire consolidated gross income tax liability of the affiliated group. The Court reasoned that since the affiliated group—and not its individual members—represented a singular taxpayer, "the credit must apply to the full amount of the affiliated group's consolidated gross income tax liability." *Id.* at 1275. In reasoning that an affiliated group should be treated as a single taxpayer, the Court commented:

The spirit and intent of the gross income tax consolidated filing statute is to treat an affiliated group as a single taxpayer. The individual provisions evidence this spirit and intent. For example, the corporations collectively file only one return. IC 6-2.1-5-5(b). The affiliated group is allowed only one standard deduction, rather than one standard deduction per corporation. IC 6-2.1-4-1(d). Each corporation is jointly and severally liable for the gross income tax liability of the entire group. IC 6-2.1-5-5(c). Additionally, transactions between corporations in the group are not counted toward gross income. IC 6-2.1-4-6(a).

Id. at 1273-1274.

With regard to deductions, this same logic compels a similar conclusion. If one is to treat "an affiliated group as a single taxpayer", then deductions properly attributable to any consolidated group member should be used to offset income earned by the consolidated group.

FINDING

Taxpayer's protest is sustained.